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April 8, 2008

TO: Supervisor Yvonne B. Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe Wendy L. Watanabe
Acting Auditor-Controller

SUBJECT: **FISCAL REVIEW OF MURRELL'S FARM AND BOY'S HOME - A GROUP HOME FOSTER CARE CONTRACTOR**

Attached is our report on Murrell's Farm and Boy's Home (Murrell's or Agency) fiscal operations from January 1, through December 31, 2004. The Probation Department (Probation) and the Department of Children and Family Services (DCFS) contract with Murrell's to operate two group homes, each with a resident capacity of six children. Murrell's is located in the Fifth Supervisorial District.

DCFS paid Murrell's $4,102 a month per child, based on a rate established by the California State Department of Social Services. Murrell's received a total of $495,952 in group home foster care funds during 2004.

Scope

The purpose of our review was to determine whether Murrell's complied with its contract terms and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures. We also evaluated the Agency's accounting records, internal controls and compliance with applicable federal, State and County guidelines governing foster care funds.

Summary of Findings

We identified $7,360 in unallowable costs and $129,858 in unsupported/inadequately supported costs. We also noted that Murrell's total liabilities exceeded its total assets by approximately $200,000. It is unclear how the Agency will obtain funding to pay its liabilities, since the Agency cannot use current period foster care funds to pay liabilities from prior contract periods. In addition, the Agency needs to develop a cost allocation plan, maintain required insurance coverage, and strengthen its internal controls over its accounting and disbursements, payroll/personnel records, bank reconciliations, and reporting of payments to independent contractors to the appropriate taxing agencies. Details of our findings are discussed in the attached report.

We have recommended that DCFS resolve the questioned costs and, to the extent possible, collect disallowed amounts. DCFS also needs to ensure that Murrell's management takes action to address the recommendations in this report and monitor to ensure the actions result in permanent changes.

Finally, due to the excess liabilities noted in our review, we have also recommended that DCFS require Murrell's management to submit a plan on how the Agency will pay its outstanding liabilities, without using current period foster care funds, and without negatively affecting the quality of services. DCFS must carefully review Murrell's plan to ensure its viability. If Murrell's is unable to provide an acceptable plan to reduce their liabilities or does not comply with their plan, DCFS should consider discontinuing doing business with Murrell's in the future.

Review of Report

We discussed our report with Murrell's management on November 30, 2007. The Agency will provide their response to our report directly to DCFS. DCFS will incorporate the Agency's response into a Fiscal Corrective Action Plan that will be submitted directly to the Board of Supervisors. We thank Murrell's management and staff for their cooperation during our review.

Please call me if you have any questions, or your staff may contact Jim Schneiderman at (626) 293-1101.

WLW:MMO:JLS:MM:ah

Attachment

c: William T Fujioka, Chief Executive Officer
Patricia S. Ploehn, Director, Department of Children and Family Services
Susan Kerr, Chief Deputy Director, Department of Children and Family Services
Robert B. Taylor, Chief Probation Officer
Emmett Murrell, Executive Director, Murrell's Farm and Boy's Home
Board of Directors, Murrell's Farm and Boy's Home
Cora Dixon, Bureau Chief, Foster Care Audit Bureau, CA Dept. of Social Services
Sheliah Dupuy, Bureau Chief, Foster Care Rates Bureau, CA Dept. of Social Services
Public Information Office
Audit Committee
Commission for Children and Families

Murrell's Farm and Boy's Home
Fiscal Review

REVIEW OF EXPENDITURES/REVENUES

We identified $7,360 in unallowable costs and an additional $129,858 in unsupported/ inadequately supported costs. Details of these costs/overpayments are discussed below.

Applicable Regulations and Guidelines

Murrell's is required to operate its group homes in accordance with the following federal, State and County regulations and guidelines:

- Group Home Contract, including Exhibit I, Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook)
- Federal Office of Management and Budget Circular A-122, Cost Principles for Non-Profit Organizations (Circular)
- California Department of Social Services Manual of Policies and Procedures (CDSS MPP)
- California Code of Regulations, Title 22 (Title 22)

Unallowable Costs

The $7,360 in unallowable costs include $2,329 in shelter costs, and $5,031 in fines penalties and other unallowable costs as detailed below.

Shelter Costs

Section 11-402.828 of the CDSS MPP specifies that group home shelter costs cannot exceed 12% of the property's fair market value (FMV). We noted that Murrell's paid approximately 14% of the FMV for its leased property, resulting in $2,329 in excess shelter costs.

Fines, Penalties, Interest and Other Unallowable Costs

Murrell's paid $5,031 in unallowable costs including: $3,320 in Non-Sufficient Fund (NSF) and returned check fees; $713 in employee personal expenses; $673 in fines, penalties and late fees; $200 in interest on an employee loan and $125 in charitable donations. According to the Circular, fines, penalties, interest payments and donations are unallowable expenses. Section C.1.5 of the A-C Handbook further states that only expenditures that are necessary, proper and reasonable to carry out the purposes and activities of the program are allowable.

Unsupported/Inadequately Supported Costs

Section A.3.2 of the A-C Handbook states that all expenditures shall be supported by original invoices, receipts, contracts, loan agreements or other documentation. Internally generated documents (e.g., vouchers, requisitions, petty cash logs, etc.) and account statements are not adequate supporting documentation. Unsupported and inadequately supported expenditures shall be disallowed upon audit.

We identified $129,858 in group home expenditures that were either unsupported or were inadequately supported:

- $31,485 in petty cash expenditures and cash withdrawals. The Agency either provided no documentation, or the documentation was limited to a cancelled check or cash withdrawal slip. No other documentation, such as original invoices or receipts, was provided.

- $26,041 in unsupported or inadequately supported expenditures to Intellesis, Palmdale Chamber of Commerce, Corporate Collection Services, Staples, Fletcher's Fire Protection, NEK Insurance and several other payees. The Agency only provided cancelled checks for $23,581 of the amount, and did not provide any documentation for the other $2,460. As a result, we could not determine whether these expenditures were related to the group homes.

- $25,653 in payments made by electronic debit. The Agency did not provide documentation for these expenses.

- $19,414 in reimbursements to four employees. The only documentation provided were the cancelled checks payable to the employees. Agency management stated that the reimbursements were for groceries, gas, office supplies, home repairs, activities or outings, clothing, and haircuts. However, they did not provide any receipts or invoices to document what had been purchased, and whether they were program-related.

- $15,765 in vehicle expenditures. The Agency did not provide any mileage records or other documentation showing how these expenditures benefited the group homes as required by the A-C Handbook.

- $11,500 in loan repayments to an employee. The Agency could not provide a written loan agreement, nor were they able to establish that the borrowed funds were deposited into the Agency's bank account.

Recommendations

1. **DCFS management resolve the $137,218 ($7,360 + $129,858) in questioned costs and pursue collection of any disallowed amounts.**

Murrell's management:

2. **Consistently maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts/invoices and mileage logs.**

3. **Ensure that foster care funds are used only for necessary, allowable and reasonable expenditures to carry out the purpose and activities of the Group Home.**

Agency Liabilities

Murrell's has approximately $200,000 in liabilities:

- As of December 2005, the Agency owed $125,505 in delinquent federal and State payroll taxes, a portion of which is unallowable penalties and interest.

- As of December 2005, the Agency had a note payable to its Executive Director for $11,988. According to Agency management, the note was for a loan the director made to the Agency. Management indicated the loan was used to repay delinquent federal payroll taxes in addition to those noted above.

- As of October 2006, the Agency owed $59,381 to Los Angeles County for overpayments by DCFS. Murrell's has an agreement to repay DCFS $1,500 per month.

Murrell's October 31, 2006 bank statements for its payroll and operating accounts showed a combined cash-in-bank balance of approximately $13,500. The Agency's audited balance sheet as of December 31, 2005, showed that the Agency's liabilities exceeded its total assets by approximately $200,000. Based on Murrell's financial position, we are concerned that the Agency might use current period foster care funds to pay its liabilities, which could result in a lower quality of care for placed children.

DCFS should require Murrell's management to submit a plan indicating how the Agency will pay its outstanding liabilities, without negatively affecting the quality of care provided to children placed in their care.

Recommendations

DCFS management:

4. **Require Murrell's to submit a plan indicating how the Agency will pay its outstanding liabilities, without negatively affecting the quality of care to placed children.**

5. **Implement an active, timely and detailed monitoring program to ensure the Agency complies with their plan.**

CONTRACT COMPLIANCE AND INTERNAL CONTROLS

We also noted a number of areas where Murrell's needs to improve its contract compliance and internal controls. DCFS should ensure that Murrell's management takes action to address the contract compliance and internal control recommendations in this report. DCFS should also monitor to ensure that the actions result in permanent changes.

Allocation of Costs

Section C.2.0 of the A-C Handbook requires contractors who operate more than one program to allocate their costs among the programs on an equitable basis.

Murrell's receives funding from a Juvenile Justice Crime Prevention Act (Probation), Community Services Block Grant Program, a School Based Supervision Program and Catholic Charities, in addition to its Group Home agreement with DCFS. For the period we reviewed, DCFS group home funds accounted for approximately 70% of the Agency's total revenues.

While the Agency recorded its general overhead expenses in their administrative cost center, we were unable to determine how much of those expenses were paid for using group home funds because the expenses were not allocated among the various programs administered by the Agency.

Recommendation

6. **Murrell's management develop a plan to allocate overhead expenses among the Agency's programs on an equitable basis.**

Insurance Requirements

Murrell's County contract requires the Agency to maintain general, auto, professional, workers' compensation and employer's liability insurance. Failure to maintain the required insurance, or provide evidence of insurance coverage acceptable to the

County, constitutes a material breach of the Contract. DCFS informed us that Murrell's auto insurance had expired.

Recommendation

7. Murrell's maintain auto insurance as required by the Contract.

Accounting Procedures and Records

We noted the following internal control weaknesses in Murrell's accounting procedures and records.

- The Agency's fixed assets are not tagged and the fixed assets list did not contain the item description, serial number, date of purchase, acquisition cost and source of funding for each asset, as required by Section B.4.2 of the A-C Handbook. The list only provided a lump sum value for all furniture and equipment and listed two vehicles. It did not identify the specific items of furniture or equipment. Fixed assets listing should be maintained in the manner prescribed by the A-C Handbook, the assets should be tagged, and an inventory of fixed assets should be conducted at least once a year to ensure that all fixed assets are accounted for and maintained in proper working order.

- Four employee loans to the Agency, totaling $15,624, were not supported by loan agreements. Section A.3.2 of the A-C Handbook states that loans by employees must be supported by a written agreement.

- The Agency does not maintain an accounts receivable ledger for payments due from DCFS. Without such a ledger, there is an increased risk that amounts payable to the Agency could remain outstanding and go undetected.

- During our review of expenditures, we noted that the Agency did not post, or incorrectly posted, numerous disbursements in their general ledger. Murrell's management should ensure that its accounting records accurately reflect the financial transactions of the Agency.

Recommendations

Murrell's management:

8. Ensure fixed assets are tagged and maintain a fixed assets listing as required by the A-C Handbook.

9. Ensure loans from employees are supported by a written agreement.

10. Maintain an accounts receivable ledger.

11. **Ensure transactions are posted and properly classified in the general ledger.**

Disbursement Procedures

We noted the following internal control weaknesses in the Agency's disbursement procedures:

- A second signature is not required on Agency checks, regardless of amount, as required in Section B.2.1 of the A-C Handbook.
- 58 of 433 checks (13%), totaling $17,454, were signed by an unauthorized check signer.
- Four checks, totaling $1,850, were signed by the payee.
- Only 77 of 433 (18%) expenditure transactions reviewed had supporting documentation.
- The supporting documentation for 25 of the 77 (32%) expenditures with documentation was not marked "Paid" or referenced to a check number. Section B.2.1 of the A-C Handbook indicates that all supporting documentation should be referenced to check numbers and marked "Paid".

Recommendations

Murrell's management:

12. **Establish a written policy to require two signatures on all checks or, at a minimum, require two signatures for large dollar disbursements.**
13. **Establish a written policy to prevent the unauthorized signing of checks and ensure that the payee and check signer is not the same person.**
14. **Ensure all vendor invoices and receipts are retained on file, marked "Paid", and referenced to cancelled checks.**

Petty Cash Procedures

We noted the following internal control weaknesses in the Agency's petty cash procedures:

- Murrell's wrote 92 checks totaling $32,732 payable to "petty cash." Section B.2.1 of the A-C Handbook states that checks shall not be made payable to cash.

- Murrell's spent an average of $2,728 a month from petty cash. Petty cash expenditures should be limited to relatively small amounts and for urgently needed items. While some of the items purchased by the Agency may have met this criteria, we noted that Murrell's used the petty cash fund when it should have used its checking account (e.g. to pay rent, groceries, gasoline, etc).

Murrell's was unable to fully account for $31,485 disbursements made from the petty cash fund. While the Agency did provide some receipts which they stated were for the petty cash disbursements, we were unable to establish exactly which disbursements related to the documentation provided. Section A.2.3 of the A-C Handbook states that cash disbursements must be supported by invoices, store receipts or other external authenticating documents indicating the item purchased and the employee making the purchase. Section A.3.4 and A.3.5 of the A-C Handbook further requires that receipts, vouchers, etc., supporting each fund replenishment must be bound together, filed chronologically and cross-referenced to the reimbursement check.

Recommendations

Murrell's management:

15. **Ensure that checks are not made payable to cash.**

16. **Discontinue the practice of using the petty cash fund as a substitute for normal purchasing and disbursement practices.**

17. **Ensure all petty cash disbursements are supported by invoices, store receipts or other external documents that are cross-referenced to the reimbursement check, and annotated to indicate information such as the name of the employee receiving the petty cash funds, the amount provided, the items purchased and the amount expended.**

Payroll/Personnel Controls

Murrell's payroll and personnel procedures were not in compliance with CDSS' MPP, Section 11-402, which requires supporting documentation for all program expenditures, including salary rates. We reviewed the personnel files and timesheets of 14 employees and noted the following:

- Two employee personnel files (14%) were not available for our review.
- Five employee personnel files (36%) did not contain a salary rate.
- Seven employee timesheets (50%) were not available for our review.
- Seven employee timesheets (50%) were not signed by a supervisor.
- One timesheet (7%) was not signed by the employee.

We also reviewed 45 payments to individuals or employees and noted the following:

- Five (11%) payments for which the Agency did not produce a W-2 or a 1099.
- Thirty (67%) payments had discrepancies between the net wages paid to the employees per cancelled checks, and the net wages shown on the W-2s.

The Agency did not maintain a payroll register, and only records net salaries in their general ledger, which understates their payroll expenses. A payroll register would document check numbers, gross wages, net pay and itemized payroll deductions such as payroll taxes, garnishments and voluntary deductions. This may explain why the Agency has not paid all of its payroll taxes and owes substantial delinquent payroll taxes to the IRS.

Section B.1.2 of the A-C Handbook states that timecards or time reports must be prepared for each pay period, and all timecards or time reports must be signed in ink by the employee and the employee's supervisor to certify the accuracy of the reported time. Section A.2.6 of the A-C Handbook recommends that a Payroll Register be maintained for payroll transactions.

Recommendations

Murrell's management:

18. Ensure personnel files are maintained for each employee and contain current authorized salary amounts or hourly rates of pay.

19. Ensure employee timecards are prepared for each pay period and signed by the employee and supervisor.

20. Prepare W-2s and 1099s as appropriate and report employee earnings to the taxing agencies.

21. Maintain a payroll register.

Bank Reconciliations

Section B.1.4 of the A-C Handbook states that monthly bank reconciliations should be prepared within 30 days of the bank statement date and be reviewed by management for appropriateness and accuracy. Both the preparer and the reviewer should sign and date the bank reconciliations.

Murrell's was unable to produce 11 of 36 monthly bank reconciliations (31%) for their three bank accounts. Of the 25 monthly bank reconciliations we received, none were signed or dated by the preparer or reviewer. In addition, the bank and book balances on the bank reconciliations did not agree to the Agency's bank statements and general ledger. Agency representatives were unable to explain these discrepancies.

Recommendation

22. Murrell's management ensure the Agency's bank reconciliations are prepared monthly within 30 days of the bank statement date, are signed and dated by both the preparer and the reviewer, and balances included in the reconciliations agree to bank statements and the general ledger.

Unreported Independent Contractor's Earnings

Section A.2.6 of the A-C Handbook states that a contractor will comply with all applicable federal and State requirements, including filing 1099s with the taxing agencies. We noted that the Agency did not issue a 1099 to report $4,000 paid to one of the Agency's independent contractors.

Recommendation

23. Murrell's management ensure that all income paid to an independent contractor is properly reported to the taxing agencies.